

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

VALASSIS NSA

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MC2012-14
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Comments of Discover Financial Services

June 29, 2010

Discover Financial Services (DFS) is pleased to submit these Comments in response to the Commission's Notice of Inquiry No. 1 (the "NOI") in this Docket, issued June 15, 2012. Comments are due June 29, 2010, pursuant to the extension in Order 1371 issued by the Commission on June 19, 2012.

DFS's Comments are limited to providing a response to the Commission's Question #7 regarding the meaning of a "similarly situated mailer" under 39 U.S.C. 3622(c)(10). DFS does not take a position regarding whether the Commission should approve the Valassis NSA, and therefore DFS's Comments do not address the underlying merits of that matter.

DFS is a financial services company that offers credit card services and other financial service products under the Discover® Card and Discover® brands. In 2004, as the very first similarly situated mailer, DFS successfully negotiated the first market dominant functionally equivalent NSA in the postal area. That NSA expired in 2007. In 2010 DFS successfully negotiated a second market dominant NSA with the Postal Service, the only one thus far under the Postal Accountability and Enhancement Act of

2006 (PAEA). Going forward, DFS may again be in the position of being a similarly situated mailer to an NSA contractee, and accordingly may wish to negotiate another functionally equivalent market dominant NSA with the Postal Service. DFS has a strong interest in functionally equivalent NSAs and how they viably should work in the marketplace, and therefore submits these comments relating to the meaning of a “similarly situated mailer” under 39 U.S.C. 3622(c)(10).¹

SIMILARLY SITUATED MAILERS

A. Public Policy.

DFS’s view is that when the Postal Service successfully negotiates a market dominant NSA with a mailer, it creates a duty to subsequently negotiate a “like” market dominant NSA with any direct competitor of that contractee. This is a duty that was clearly understood when DFS negotiated its first NSA in 2003 with the Postal Service, and when that NSA went to the Commission in 2004 for approval. It was a duty that also was well understood during the Congressional debate that led up to the passage of the PAEA and it was a duty that was embedded in that Act. Finally, this is also a duty

¹ In terms of procedure, DFS believes that in considering NSAs, the Commission has a duty to respect the integrity of the contractual bargaining process. DFS would suggest that, under no circumstances should the Commission rewrite any contract term in this case, or second-guess the balance of the benefits and risks that both parties made in the contract, and the duties and responsibilities that each has assumed in the contract. To do so would be to upset the delicate mechanics of the contracting process, artificially distort the bargain the parties have reached, and set a most destructive precedent.

If the Commission finds the current Valassis NSA unlawful but would find it lawful with some modification or adjustment, then it is DFS’s view that the Commission should reject the contract and return the contract to the Postal Service and Valassis with an indication as to how to make the contract acceptable. This would allow the Postal Service and Valassis to consider the matter and decide how and where to rebalance the benefits and risks and rework the terms assigning their duties and responsibilities under the contract. See Order 1391 in Docket RM2003-5, February 11, 2004 at 21 (Order establishing rules for baseline and functionally equivalent Negotiated Service Agreements).

that has been implicitly recognized by all parties throughout the evolution of the NSA process.

The purpose of the duty to negotiate a “like” market dominant NSA with any direct competitor of the NSA contractee is to ensure that that when a business-like establishment of the federal government enters into a contract with one company to provide services for a price, that company’s direct competitors are not put at a serious disadvantage and the market is not thereby disrupted. The reason for this is straightforward. Basic notions of the appropriate role of government in our free market economy require noninterference from the government in the competitive marketplace to the maximum degree possible, and demand that the government not engage in consciously influencing winners and losers in private sector markets. The government is supposed to be a neutral umpire in markets, not a player. These concerns do not exist in other regulatory regimes, where the regulated entity is a private sector entity.

Since the Postal Service is an independent establishment of the federal government, and not a private sector entity, this principle applies in the market dominant area. Thus, if the Postal Service negotiates a market dominant deal with one company, it must be prepared to negotiate a “like” deal with that party’s competitors. This functionally equivalent concept was embodied in the Commission’s original NSA rules, and was codified by Congress in the PAEA.

While the Commission indicated in its Capital One Decision that the concept of “functional equivalency” could extend beyond an NSA contractee’s competitors, that concept has never been developed or tested. See MC 2002-1 Opinion and Recommended Decision at 135-40 (May 15, 2002). Indeed, from a practical point of

view, the universe of functionally equivalent mailers has been limited to competitors. From DFS's point of view, this makes sense since a fundamental part of the Postal Service's analysis in negotiating market dominant NSAs has not just been mailing and cost characteristics, but an analysis of market place factors and the marketplace in which the NSA contractee is operating.

While mailers in other industries that do not compete with the NSA contractee might share some of the mailing and operational characteristics of the NSA contractee, they normally would not—by definition—share market and demand characteristics, as they are not in the same market competing for the same dollar. Thus the breadth and depth of the market characteristics that the Postal Service would have to examine in negotiating a functionally equivalent NSA with another mailer would normally be quite different than those of the original NSA contractee. For instance, market participants in one market may be generally decreasing their use of the Postal Service while participants in another market may be generally increasing their use of the Postal Service. This could make the other mailer not a fit candidate to be a similarly situated mailer.² Thus, logically and practically speaking, functionally equivalent mailers should be limited to those operating in the same market, competing for the same dollar. See *infra*, at 5.

In terms of the type of “like” deal that similarly situated mailers deserve, the “like” deal need not be exactly the same deal—just as DFS' original NSA did not mirror that of Capital One—but one that is functionally equivalent. This is the only rational since it would be unreasonable to expect a mailer that is similarly situated to a larger competitor

² This is not to suggest that this other mailer would not be a fit candidate for an original NSA, but only to suggest that this other mailer would not have a “right” to a functionally equivalent NSA.

to meet the same size thresholds, penalties, and triggers that its larger competitor must meet. This point is illustrated in the original set of financial services NSAs.

In Clause II E of the original Capital One NSA, the size of the penalty Capital One agreed to pay under certain circumstances was \$1 million, while the size of the corresponding penalty that DFS (a smaller mailer) agreed to pay in its NSA was less. *Compare* Capital One NSA in MC 2002-1 at IIE *with* DFS NSA in MC 2004-4 at IID.

The same was true of the functionally equivalent NSAs that the Commission approved for Bank One and HSBC in 2004 and 2005. See Bank One NSA in MC 2004-3 at IID and HSBC NSA in MC 2005-2 at IID. Moreover, as Sections IID of these NSAs (IIE of the Capital One NSA) show, the thresholds that could have triggered these penalties were not the same size in any of the contracts because of the different circumstances and size of the mailers.

B. Similarly Situated Mailers Should Include All Direct Competitors.

Given the concern with competition in the private marketplace that is the public policy core of this issue, DFS suggests that a similarly situated mailer must include all direct competitors, ones that are similarly situated in the economic marketplace and compete for the same dollar. A “competing for the same dollar” test is a test that implicitly defines a market and ensures that all similarly situated entities are competing in the same economic market, and thus have at least some common market characteristics. Were the Commission not to consider all competitors as functionally equivalent mailers, significant negative repercussions would inevitably occur in the mailing community, in Congress, and in the marketplace.

Additionally, from a practical point of view, DFS suggests that the concept of similarly situated mailer need go no further than the direct competitor. If the Commission were to limit the concept of the functionally equivalent mailer to only direct competitors, the NSA process would be much simpler, and the success of NSAs in helping the Postal Service rebuild would be much greater. This is not only because it would make more sense, but because it would also make it much simpler for a mailer to quantify its chances of success in an NSA venture, and make it much more efficient for the Postal Service to engage in its market and risk analysis. It would also help smaller mailers enter into the NSA process.

Doing anything else—i.e., creating a functionally equivalent analysis that is based on mailing characteristics rather than market characteristics—would introduce undesirable complexities and nuisances. Such a result is unnecessary and undesirable because it would enormously complicate the market and the risk analysis that the Postal Service must undertake when it decides to engage in NSA contract talks.

Many in the postal community may not appreciate the key role that markets and market analysis play in assessing risk and negotiating NSAs. Indeed, it was not until after DFS had negotiated its second NSA that it came to have a finer appreciation of the central role that market analysis plays in this process. Since negotiating an NSA is fundamentally a pricing process, and since the PAEA pushed the Postal Service to price to the market, limiting similarly situated mailers to competitors (that are by definition in the same market) is the most appropriate course of action the Commission could take.

To illustrate how DFS envisions what a similarly situated mailer should be, let us consider DFS's current NSA. DFS is a financial services company. Thus, functionally

equivalent mailers for purposes of our second NSA should be all financial services companies and no one else. However, since a definition of a financial services company might be somewhat ambiguous, DFS would suggest that a bright line regulatory test should focus on what mail is sent and to whom it is sent. Thus, DFS suggests that an appropriate test for the Commission to use would be:

A similarly situated mailer is an entity that utilizes, or proposes to utilize, the mail to market the same or similar goods or services, or to mail comparable information to the same or similar persons as an NSA contractee.

That doesn't mean that companies that may look somewhat like DFS in terms of mailing characteristics but are not direct competitors—*e.g.*, insurance companies, telecommunications companies, and perhaps utilities—could not negotiate their own similar contract with the Postal Service. They obviously could do so and the Postal Service would have an economic incentive to maximize its revenue by doing so. Indeed, if the Postal Service would make money in one instance in one market, it more than likely could make money with a similar contract in another market, with the proper threshold and terms. But such contracts in other markets would *not* be functionally equivalent contracts with similarly situated mailers, and those mailers would not have a legal “right” to any such contract, since no competitive forces would be implicated.

As noted above, to do anything else would overly complicate the NSA process, a process that Congress intended to simplify in the PAEA. Also, creating some sort of complicated economic or operational test for similarly situated mailers that goes beyond direct competitors would create a classification that does little to nothing to serve the public policy purpose of the provision in the law—to maintain a level playing field between competitors and avoid serious and unreasonable market disruption.

CONCLUSION

The Commission should strive to make the NSA a viable pricing tool for the Postal Service, which means ensuring that all competitors have the opportunity to obtain a functionally equivalent NSA. That is what Congress intended when it passed the PAEA in 2006. Requiring complex and complicated analysis of what constitutes a similarly situated mailer beyond competitors, or not including some competitors because of their mailing characteristics, would bog down the entire process and have the exact opposite effect from what Congress intended.

Thank you for considering our views.

Respectfully submitted,

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